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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

No. 36

IN THE MATTER

of

FLORIDA EAST COAST RAILWAY COMPANY,
Debtor,

J. BRYSON AIRD and BANK OF THE MANHATTAN COMPANY, Successor Mortgage Trustees,
Petitioners,

vs.

ATLANTIC COAST LINE RAILROAD COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF ON BEHALF OF J. BRYSON AIRD AND BANK OF THE MANHATTAN COMPANY, SUCCESSOR MORTGAGE TRUSTEES, PETITIONERS

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Dated: October 14, 1953

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The respondent Coast Line in its answering briefs, not only with respect to our appeal (No. 36) but also with respect to the other related appeals (Nos. 24, 33 and 37), has raised many points which seem to be far beyond the scope of the question on which certiorari was granted; and we do not propose to be drawn into arguing points in which this Court has not indicated interest. However, the fol-

lowing comments by way of reply to the Coast Line's brief in No. 36 seems to us to be in order.

"The Opposition to the Plan"

(Coast Line brief in No. 36, pp. 6-9)

The Coast Line argues that the certified plan now on appeal is of great value to the holders of some $10,000,000 of the 5% Refunding Mortgage Bonds who have not actually intervened in the proceedings and who have not expressly indicated approval or disapproval of the certified plan. None of the arguments of the Coast Line along these lines seems to be appropriate. The Coast Line, on page 5 of its Brief in opposition to the Mortgage Trustees' application for certiorari (No. 670), stated:

> "We do not concede that it would make any difference whether there are or are not any bondholders 'now actively supporting the plan'."

If the Coast Line does not concede that the amount of bondholders' support or lack of support of the plan makes a difference, why is it necessary to labor the point at all, since it serves only to confuse an intelligent consideration of the certified question. Concededly the holders of far better than a majority of amount of the bonds and the Mortgage Trustees, *acting in the interests of all bondholders* and in the exercise of their best judgment, are opposed to the plan.

Is the Merger Favorable to Minority Bondholders?

(Coast Line Brief in No. 36, pp. 10, 18-23)

Apparently as background the Coast Line argues that "the Mortgage Trustees have frankly taken the position, first, that it is none of their business whether the holders of the unrepresented bonds would do better under the Commission's plan or under an internal reorganization, and

second, that it is no business of the Commission or the court either" (Coast Line brief in No. 36 at p. 10). This unwarranted statement, which has no bearing whatever upon the question presented, nevertheless cannot be allowed to pass unchallenged. In Appendix A of this reply brief will be found a brief outline of the number of occasions in the course of the proceedings below upon which the Successor Mortgage Trustees have urged, on behalf of all the bondholders, the inadequacy of the price to be paid by the Coast Line for the debtor's assets. In Appendix B we quote from the brief filed on behalf of the Mortgage Trustees in the District Court, from which it can be seen clearly that the Trustees' analysis of the present plan resulted in their concluding that it was more unfavorable to the 5% Bondholders as a whole, by at least $1,900,000, than its immediate predecessor, which had been condemned by the Fifth Circuit Court of Appeals in 1949 as unfair and inequitable.

The "Denver Case"

(Coast Line Brief in No. 36, pp. 24-27)

The Coast Line answers our arguments regarding the conscious intentions of the Congress in August, 1935, when the amendments to Section 77 were passed, by calling them frivolous in the light of the *Denver* case (328 U. S. 495), decided in 1946. At the time of writing the main brief we were fully aware of the *Denver* case and considered the opinion in that case to be in all respects sound. But we cannot understand what bearing that case has on the question here presented, which relates to the conscious intentions of the Congress, *some ten years before that opinion was written*, with respect to empowering the Commission to sell all of the mortgaged assets of a debtor railroad to a third party at a price reached not by any of the conventional methods of valuation but solely by an attempted estimate of the future earnings of the debtor.

If the opinion in the *Denver* case clearly answers the only question presented on this appeal, it would seem that

this Court would not have granted certiorari in the first place.

In this irrelevant attack on our argument as to the intent of Congress in 1935, counsel for the Coast Line argue that there is no difference between, *on the one hand*, a *Denver* case type of reorganization, which involves the scaling down of the corporate structure of a large railroad and the division of its assets equitably among many and varied classes of secured creditors having in many cases overlapping or conflicting security interests in the debtor's property, and, *on the other hand*, a reorganization such as is presented here, where, although there is only one class of secured creditors and that class has a security interest in 98% of the debtor's assets, the reorganization plan provides for a forced sale of those assets to an outside railroad at an arbitrary figure based solely on earnings forecasts. We believe that there is a clear difference between these two types of reorganizatior and that the *Denver* case is not pertinent to the present reorganization. But in any event, to cite the *Denver* case, as counsel for the Coast Line have done, in complete answer to the argument in our main brief as to the intent of Congress in 1935 is simply begging the question.

Respectfully submitted,

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APPENDIX A

OUTLINE OF THE SUCCESSOR MORTGAGE TRUSTEES' ACTIVITY IN OBJECTING (BEFORE COMMISSION AND COURTS) TO THE INADEQUACY OF THE COMPENSATION OFFERED BY THE ATLANTIC COAST LINE TO THE FIRST AND REFUNDING MORTGAGE BONDHOLDERS

In the District Court proceedings before Judge Sibley, on the earlier plan, the Successor Mortgage Trustees adopted their predecessors' objections to inadequacy of consideration (Mortgage Trustees' brief of January 14, 1949), which had been filed in the District Court on June 30, 1948. They also participated actively in the hearings before Judge Sibley (see 81 F. Supp. 926 at p. 930); and filed a brief objecting to the inadequacy of the consideration offered the bondholders under that plan (Mortgage Trustees' brief of January 14, 1949, Point III).

In the Circuit Court proceedings on the old plan, the Mortgage Trustees participated actively through counsel (see 179 F. 2d 538 at p. 539) and filed a brief pointing out the inadequacy of the consideration under that plan (Mortgage Trustees' brief of August 31, 1948, Point III).

In the proceedings before the Interstate Commerce Commission in 1950, the Record (at p. 151) shows that the Mortgage Trustees offered expert testimony on the inadequacy of the compensation offered by the Coast Line plan (which was substantially the present plan). They also submitted to the Commission briefs dated October 9, 1950, and November 15, 1950, pointing out in detail the inadequacy of the consideration and stating that for this reason they were opposed to the plan proposed by the Coast Line.

After the Commission issued its Fifth Supplemental Report formulating the present plan, they filed (as will appear from the Sixth Supplemental Report itself—see the Record, Vol. I, p. 195), a petition dated September 6, 1951 (and a reply dated September 27, 1951) for modification of the

present plan based, among other things, on the inadequacy of the consideration offered, which petition was denied by the Sixth Supplemental Report.

Thereafter the Mortgage Trustees filed objections to the present plan in the District Court based, among other things, on inadequacy of consideration (see the Record, Vol. III, p. 1).

They participated actively in the District Court hearings on the present plan before Judge Strum (see 103 F. Supp. 825 at p. 827) and filed a brief in those proceedings dated February 8, 1952, challenging, among other things, the adequacy of the consideration. In that brief, upon careful and impersonal analysis they reached the conclusion (which they still hold) that the present plan's compensation to the bondholders is at least $1,900,000 below that afforded even by the old condemned plan (for the details of the analysis by which the Trustees reached that conclusion, see Appendix B), and far less valuable to the minority bondholders than that offered by the internal reorganization plan agreed upon.

In the Circuit Court of Appeals on the appeal from Judge Strum's ruling on the present plan, in addition to collaborating in a joint brief with other interested parties and participating in the argument (201 F. 2d 325 at p. 325), the Mortgage Trustees filed a separate supplemental brief dated September 3, 1952, pointing out, among other things, the inadequacy of the consideration (see pp. 6-8 of the supplemental brief).

In the Mortgage Trustees' petition of April 6, 1953, for the writ herein, they again pointed out that the present plan "is grossly unfair and inequitable to the bondholders as a class" and that the compensation offered under the plan is inadequate (see p. 4 of the petition).

APPENDIX B

EXCERPT FROM MORTGAGE TRUSTEES' BRIEF OF FEBRUARY 8, 1952, IN THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF FLORIDA:

"A. The 1951 Plan is more unfair and inequitable than the Condemned Plan.

The Fifth Supplemental Report, at page 217 (of Doc. 938), conveniently and misleadingly sets out in tabular form the *ostensible* compensation offered the Refunding Bondholders under the condemned plan and under the 1951 Plan. By comparing column 4 with column 6 in that table it can be quickly noted that ostensibly under the 1951 Plan there is an *increase* of $500,000 face amount in Atlantic Coast Line First Mortgage Bonds, and an *increase* of $5,625,000 in Atlantic Coast Line contingent interest bonds, partially offset by a *diminution* of $125,000 in cash to be contributed by the Atlantic Coast Line—an *ostensible* net increase of $6,000,000 face value in the compensation offered.

If that *ostensible increase* were not entirely offset by *deductions* undisclosed in the Commission's table, it might be argued that the 1951 Plan had met the first or comparative test. But to make an *actual* comparison of the two plans we must subtract from the compensation offered under the 1951 Plan at least $8,000,000 which the condemned plan gave to the Bondholders and which the 1951 Plan takes from them.

This surgical operation by the Commission is shielded from the eye by the Commission's innocent appearing foot note to the table, reading "Possible cash distributable from the Debtor's treasury not included, because of its indefiniteness at varying dates and consequent difficulty of comparing like with like" (p. 217).[6] Actually this foot note con-

[6] Page references, when not otherwise indicated, are to the Fifth Supplemental Report of the Interstate Commerce Commission as printed in Reorganization Document No. 938.

ceals the facts that the Refunding Bondholders have been deprived of at least $4,430,005 in Court imposed liens which the Coast Line would have been compelled to pay under the Third Plan; and that they have been required to contribute to the Coast Line out of the Debtor's cash, $3,500,000 toward additional new reserves which were not previously provided for and which therefore would have been paid to the Refunding Bondholders under the Third Plan.

The Liens.

Contemporaneously with certification of the Third Plan this Court imposed liens in favor of the Refunding Bondholders upon certain assets, largely new equipment, purchased by the Debtor's Trustees with cash resulting from the Debtor's earnings in an amount which even the Commission's low net figure places at $4,619,005. (p. 223). The earnings so diverted would otherwise have been available for distribution to the Bondholders either as interim payments of back coupons or as a principal cash distribution at consummation of the reorganization. As the Court pointed out and as the Commission recognized "* * * the funds were diverted, not to ordinary maintenance or operation, but to pay for additional equipment, additions and betterments * * * To secure this reimbursement, the Bondholders are entitled to a lien superior to any interest acquired by new parties who receive the benefits of these extraordinary additions and betterments through reorganization."

It is beyond question that the purpose of these liens (which were first imposed while the condemned plan was being approved by the Commission but before its condemnation by this Court) was to require the Atlantic Coast Line (should it be granted the Debtor's road in reorganization) to pay *additional* compensation over and above that provided by the Third Plan sufficient for additions paid for by the Bondholders after the compensation under the Third Plan had been fixed. It is therefore also

beyond doubt that to compare the Third Plan with the Fourth Plan we must ascertain whether the Bondholders will be compensated for these liens under the Fourth Plan; and that if they will not be compensated we must then subtract the amount of the liens from the Fourth Plan compensation for comparative purposes.

The Fourth Plan does not compensate for these liens. It specifically provides that to the extent these liens are paid, a corresponding amount of Atlantic Coast Line first mortgage bonds will be deducted from the purchase price (p. 230). (We do not overlook, nor do we regard as significant the $189,000 pittance thrown to the bondholders from the $4,000,000 paid to cover the "bought in" first mortgage bonds). In other words, the amount of Coast Line First Mortgage Bonds carried at $14,000,000 on the Commission's table of compensation at page 217 of the Fifth Supplemental Report *is reduced by* $4,430,005!

The Reserves

Under the Third Plan the Coast Line was *to receive*, at completion of the reorganization, as contribution toward reserves for the reorganized road only (a) $500,000 toward capital plus (b) *the then remaining balance* of a special reserve fund (267 I. C. C. 377) which aggregated $7,525,511 at the time of the Fourth Supplemental Report (267 I. C. C. 363), after appropriate expenditures by the Railroad Trustees out of that special reserve fund. By December 31, 1949 the Railroad Trustees had expended (for the purpose for which it was created) *all* of that special reserve fund (Loftin Exhibit 304, proceedings before the I. C. C. August 1950). There accordingly is no *balance* of that reserve today and under the condemned plan the Bondholders would today make (aside from $500,000 toward capital) *no contribution toward reserves*, because they have already made and exceeded the contribution required of them under the condemned plan.

However, under the Fourth Plan, the Bondholders are flatly required to contribute to the Atlantic Coast Line out of the Debtor's cash, new and additional sums of $3,000,000 toward a stations reserve, and $1 000,000 (instead of $500,000) toward a working capital r serve (p. 229), or an aggregate additional contribution of $3,500,000.

Under the Third Plan this $3,500,000 aggregate of cash would have been distributed to the Bondholders, not to the Coast Line as it is under the Fourth Plan. It is accordingly inescapable that from a comparative standpoint, this sum of $3,500,000 must also be deducted from the compensation offered by the Fourth Plan before that Plan can be compared with the Third Plan—already condemned.

The Successor Mortgage Trustees accordingly submit that after making these deductions of $4,430,005 and $3,500,000 from the *ostensible* compensation offered by the Fourth Plan, it becomes apparent that that plan is demonstrably inferior to the Third Plan by at least $1,930,005.

On this showing alone the Court should disapprove the Fourth Plan."